

No. 11070 - 11071

United States
Circuit Court of Appeals
For the Ninth Circuit.

BYRON C. HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the Tax Court
of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES:

For Taxpayer:

A. CALDER MACKAY, ESQ.,
ADAM Y. BENNION, ESQ.

For Comm'r:

EARL C. CROUTER, ESQ.

Docket No 739

BYRON C. HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1943

Feb. 10—Petition received and filed. Taxpayer notified. Fee paid.

Feb. 11—Copy of petition served on General Counsel.

Apr. 8—Answer filed by General Counsel.

Apr. 8—Request for hearing in Los Angeles, California, filed by General Counsel.

Apr. 14—Notice issued placing proceeding on Los Angeles, California calendar. Service of answer and request made.

1944

Feb. 29—Hearing set April 24, 1944 in Los Angeles, California.

Apr. 27, 28—Hearing had before Judge Hill on merits. Motion of counsel for petitioner to consolidate the cases and there being no objection by counsel for respondent, Ordered that the cases be consolidated. Entry of appearance of A. Calder Mackay, Esq., and A. Y. Bennion filed at hearing. Briefs due 6/13/44. Replies 6/28/44. (Simultaneous)

June 1—Motion for extension to July 1 and July 22, 1944 respectively, to file original and reply brief filed by General Counsel. 6/2/44 Granted.

June 12—Motion for extension to July 1 and July 22, 1944 respectively, to file original and reply brief filed by taxpayer. 6/13/44 Granted.

June 19—Transcript of hearing 4/27/44 filed.

June 23—Motion for extension to July 18, 1944 to file brief filed by taxpayer. 6/26/44 Granted.

July 1—Brief filed by General Counsel. Served 8/2/44.

July 12—Motion for extension to Aug. 3, 1944 to file original brief and to Aug. 24, 1944, respectively, to file reply brief, filed by taxpayer. 7/13/44 Granted.

Aug. 2—Brief filed by taxpayer. 8/2/44 Copy served.

1944

Aug. 17—Reply brief filed by General Counsel.

Aug. 24—Reply brief filed by taxpayer. Copy served.

1945

Jan. 15—Memorandum findings of fact and opinion rendered. Judge Hill. Decision will be entered for respondent. Copies served.

Jan. 15—Decision entered. Judge Hill. Div. 2.

[1*]

Apr. 12—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Apr. 13—Proof of service filed by taxpayer.

May 19—Statement of points to be relied on and designation of parts of the record to be printed filed by taxpayer with proof of service thereon.

May 19—Stipulation adopting as a statement of evidence in this cause the statement of evidence prepared served and filed in the cause of Daisy May Hanna filed by taxpayer.

May 19—Designation of contents of record filed by taxpayer with proof of service thereon.

May 23—Certified copy of order from U. S. Circuit Court of Appeals, 9th Circuit, extending time to 6/22/45 to prepare and deliver the record. [2]

The Tax Court of the United States

Docket No. 739

BYRON C. HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency LA:IT:90D:PB, dated November 17, 1942; and as a basis of his proceeding, alleges as follows:

(1) The petitioner is an individual whose office is located at 1126 Pacific Mutual Building, Los Angeles, California. The return for the period here involved was filed with the Collector for the Sixth District of California.

(2) The Notice of Deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on November 17, 1942. [3]

(3) The taxes in controversy are income taxes for the calendar year 1940 in the amount of \$4,134.55. The Notice of Deficiency discloses a deficiency of \$4,143.24, which includes a deficiency for the calendar year 1939 in the amount of \$8.69, concerning which no question is raised.

(4) The determination of taxes set forth in the

said Notice of Deficiency for the calendar year 1940 is based on the following errors:

(a) The addition and inclusion in petitioner's income for said calendar year of the amount of \$28,821.94 as Partnership Income;

(b) The rejection of the application of section 107 of the Internal Revenue Code to a fee received by the partnership of Hanna and Morton in 1940, earned by services extending over a period of eight years.

(5) The facts upon which petitioner relies as the basis of this proceeding are as follows:

A. That at all times herein mentioned Byron C. Hanna and Harold C. Morton were equal copartners engaged in the practice of law in the city of Los Angeles, state of California, under the firm name and style of Hanna and Morton.

B. In July 1932, Mr. Etienne Lang, representing the Lazard family, consulted Harold C. Morton, partner of the undersigned, with reference to an important action to be brought on behalf of members of the Lazard family.

Thereafter, on August 14, 1932 Mr. Lang paid the firm of Hanna and Morton, of which petitioner is a partner, [4] \$2,500 for preliminary work, which included the drafting of a complaint to be submitted to the examination of French counsel.

At that point the service for which the \$2,500 was paid was complete. There was no obligation on the part of Hanna and Morton to render any further service or to proceed with any action, and no

obligation on the part of the clients to employ said firm any further.

C. Thereafter, in October 1932, Mr. Lang negotiated with Mr. Morton for the employment of Hanna and Morton to conduct said contemplated litigation.

Four different bases of compensation were suggested by Mr. Lang, and the basis of compensation set forth in the contract, a copy of which is annexed hereto and marked "Exhibit B" was selected and accepted by Hanna and Morton.

The contract provides for the immediate payment of \$30,000. The actual amount to be paid was \$27,500. The figure of \$30,000 was inserted at the suggestion of Mr. Lang so as to include and evidence the payment of the \$2,500 previously paid; but said amount of \$2,500 at that time had been entirely earned and paid on August 14, 1932, and represented compensation for an employment separate and distinct from work to be done under the terms of the contract. [5]

D. The sum of \$27,500 was paid to Hanna and Morton on October 15, 1932, upon the execution of the contract.

E. It was known to all parties at that time (October 15, 1932) that there would be large and substantial costs incurred in connection with the litigation to be prosecuted; and under the terms of the contract, Hanna and Morton assumed the absolute and unconditional obligation to defray the expense of such costs.

By executing the contract and receiving the sum of \$27,500 they also assumed the fiduciary obligation to apply as much of the said sum of \$27,500 as might be required, or all of it if all were required, to the payment of such expenses and costs.

F. At the time of the receipt of said sum of \$27,500 it was not contemplated by the parties that said sum or any part of it would constitute a fee or income to Hanna and Morton except and until all of the expense and costs of such litigation had been paid.

G. The fee for the professional services to be rendered in the litigation was contingent upon success and was to be determined by calculating a percentage of the recovery as set forth in the contract. [6]

H. Consistent with the method of accounting used by Hanna and Morton, the cash payment of \$27,500 was treated in the books of said partnership as a trust fund against which the direct expenses and costs of the litigation were charged. There was also transferred from said trust fund to the partners or to the general account of the partnership the sum of \$5,500, as follows:

October 15, 1932	\$2,000.00
October 31, 1932	1,500.00
May 1, 1933	1,000.00
October 31, 1936	1,000.00
	<hr/>
Total	\$5,500.00

These amounts were transferred to partially compensate the partnership for expenses in connection

with said employment, including salaries of lawyers employed by the partnership, stenographic help, stationery, etc., incident to the work of said employment and which expenses were paid out of the general funds of the partnership and not charged directly against said trust fund.

I. Consistent with the foregoing, the petitioner in each of the calendar years noted in the preceding paragraph, returned as income the amount received by him by reason of his participation in the amount [7] transferred to the General Account of the partnership during each such calendar year respectively as hereinbefore set forth.

Aside from such amounts, petitioner did not include in his income tax returns for the calendar year 1932 or for any year subsequent thereto until 1940, any other portion of said sum of \$27,500, but at all times treated and regarded the said sum, excepting the portions thereof transferred to the General Account of the partnership, as aforesaid, as trust funds which did not constitute income to petitioner.

J. In 1941 petitioner filed an income tax return reporting as income petitioner's community share in said fee upon the basis provided in section 107 of the Internal Revenue Code.

The Notice of Deficiency disallows this method of returning the said community income of petitioner resulting from said fee, and upon that basis adds to the community income of petitioner for the year 1940 the sum of \$28,821.94 upon which the deficiency for said year is calculated.

It is the addition of this amount of income to petitioner for the calendar year 1940, and the rejection of the application of section 107 of the Internal Revenue Code, which petitioner alleges to be erroneous. [8]

K. The litigation was successfully concluded in 1940, and the contingent fee collected. At that time the unexpended balance in the trust fund amounted to \$7,769.55. This was considered as income earned in that year and was transferred to the general funds of the partnership and added to the contingent fee.

L. The Notice of Deficiency is based upon the assumption that the cash payment of \$27,500 in 1932 was part of the total fee, and that as a result, an amount in excess of five per cent of the total fee was thus received.

The notice, however, ignores the fact that upon that theory the \$27,500 should have been returned as income in 1932, and would be assessable as income in 1932. This is a necessary consequence of the application of the theory upon which the notice of deficiency is based.

M. The undersigned alleges that the payment of \$27,500 received in 1932 was accepted subject to an unconditional obligation to pay and defray the expenses of said litigation in an indeterminable amount but nevertheless in an amount which it was then known would be very substantial. No part of said \$27,500 could be treated as income or profit until [9] the complete performance of the obligations of the contract, and therefore the portions

thereof, if any, returnable as income, could only be determined at such time.

N. Petitioner alleges that petitioner's part of the income under this contract was received as follows:

1932 Payment	\$ 27,500.00	
Litigation Costs during period		
1932 and 1940	\$ 14,230.45	
Portion taken into Partnership income		
in 1932, 1933 and 1936.....	5,500.00	19,730.45
		<hr/>
Determined by Events as Fee in 1940		\$ 7,769.55
Contingent Fee (1940)	\$114,018.19	
Paid to Other Lawyers.....	6,500.00	107,518.19
		<hr/>
Total Fee—1940		\$115,287.74
		<hr/> <hr/>

Petitioner further alleges that the application of section 107 of the Internal Revenue Code is permissible; and if said section is applied, there is no deficiency for the calendar year 1940.

O. Petitioner further alleges that if said section 107 of the Internal Revenue Code is not applicable, then the amount of \$27,500 should be assessed as income received by the partnership in 1932 and deducted from the total income received by the partnership in 1940; and that the additional tax assessed to petitioner in the Notice of Deficiency should be accordingly reduced. [10]

Wherefore, the petitioner prays that this Honorable Court may hear the proceeding and:

- (1) Determine that no deficiency exists for the calendar year 1940; or
- (2) If it be determined that section 107 of the

Internal Revenue Code is not applicable to the fee above referred to, then that the item of \$27,500 received in 1932 shall be treated as partnership income for that year; and that petitioner shall be assessed on his participation in said sum for that year, and that the amount so determined to have been received in 1932 shall be deducted from the amount of said fee charged to petitioner as having been received in 1940, and the deficiency reduced accordingly.

BYRON C. HANNA
In Propria Persona [11]

EXHIBIT A

Treasury Department
Internal Revenue Service
Twelfth Floor, U. S. Post Office and Courthouse
Los Angeles, Calif.

Nov. 17, 1942

Office of
Internal Revenue Agent in Charge
Los Angeles Division
LA:IT:90D:PB

Mr. Byron C. Hanna,
1126 Pacific Mutual Building,
Los Angeles, California.

Sir:

You are advised that the determination of your income tax liability for the taxable years ended De-

cember 31, 1939 and December 31, 1940 discloses a deficiency of \$4,143.24 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By GEORGE D. MARTIN (Signed)

Internal Revenue Agent in
Charge.

Enclosures:

Statement.

Form of waiver. [12]

Statement

LA:IT:90D:PB

Mr. Byron C. Hanna,
1126 Pacific Mutual Building,
Los Angeles, California.

Tax Liability for the Taxable Years Ended
December 31, 1939 and 1940

Income Tax.

Year	Liability	Assessed	Deficiency
1939	\$ 530.86	\$ 522.17	\$ 8.69
1940	9,544.52	5,409.97	4,134.55
	<hr/>	<hr/>	<hr/>
Total	\$10,075.38	\$5,932.14	\$4,143.24

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of the deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition The Tax Court of the United States for a redetermination of the deficiency.

A copy of this letter and statement has been mailed to your representative, Mr. Edgar P. Lyons, 639 South Spring Street, Los Angeles, California, in accordance with the authority contained in the power of attorney executed by you. [13]

Adjustment to Net Income
Taxable Year Ended December 31, 1939

Net income as disclosed by return.....	\$10,355.79
Additional income:	
Partnership income	90.56
	<hr/>
Net income adjusted	\$10,446.35

Explanation of Adjustment

Your share of the net income from the partnership of Hanna and Morton has been increased in the amount of \$90.56.

Computation of Tax
Taxable Year Ended December 31, 1939

Net income adjusted	\$10,446.35
Less: Personal exemption	1,719.85
	<hr/>
Balance (surtax net income).....	\$ 8,726.50
Less: Earned income credit (10% of \$10,446.35).....	1,044.64
	<hr/>
Net income subject to normal tax.....	\$ 7,681.86
Normal tax at 4% on \$7,681.86.....	\$307.27
Surtax on \$8,726.50	223.59
	<hr/>
	\$ 530.86
Total income tax	\$ 530.86
Correct income tax liability	\$ 530.86
Income tax assessed:	
Original, account No. 251651	522.17
	<hr/>
Deficiency of income tax	\$ 8.69

[14]

Adjustments to Net Income
Taxable Year Ended December 31, 1940

Net income as disclosed by return	\$11,618.80
Additional income:	
(a) Partnership income	28,821.94
	<hr/>
Total	\$40,440.74

Reduction in income:

(b) Adjustment of "other income"..... 874.42

Net income adjusted\$39,566.32

Explanation of Adjustments

(a) Your share of the net income from the partnership of Hanna and Morton has been increased in the amount of \$28,821.94. Said partnership income is not entitled to be taxed under the provisions of section 107 of the Internal Revenue Code.

(b) The amount of \$1,748.85 reported as "other income" represents gain from the sale of a capital asset held for more than two years, and therefore 50% of this amount, or \$874.43, has been determined as long-term capital gain, in lieu of the income of \$1,748.85. [15]

Computation of Alternate Tax

Taxable Year Ended December 31, 1940

Net income adjusted\$39,566.32

Minus: Net long-term capital gain 874.43

Ordinary net income\$38,691.89

Less: Personal exemption\$1,020.26

Credit for dependent 400.00 1,420.26

Balance (Surtax net income)\$37,271.63

Less: Earned income credit 1,400.00

Net income subject to normal tax.....\$35,871.63

Normal tax at 4% on \$35,871.63.....\$1,434.87

Surtax on \$37,271.63 6,979.64

Partial tax\$ 8,414.51

Plus: 30% of \$874.43 net long-term capital gain..... 262.33

Alternative tax\$ 8,676.84

Computation of Tax

Taxable Year Ended December 31, 1940

Net income adjusted	\$39,566.32
Less: Personal exemption	\$1,020.26
Credit for dependent	400.00 1,420.26
Balance (surtax net income)	\$38,146.06
Less: Earned income credit	1,400.00
Net income subject to normal tax.....	\$36,746.06
Normal tax at 4% on \$36,746.06.....	\$1,469.84
Surtax on \$38,146.06	7,272.58
Total normal tax and surtax	\$ 8,742.42
Alternative tax	8,676.84
Defense tax (10% of \$8,676.84)	867.68
Total income tax	\$ 9,544.52
Correct income tax liability	\$ 9,544.52
Income tax assessed:	
Original, account No. 203573	5,409.97
Deficiency of income tax	\$ 4,134.55

[17]

EXHIBIT B

EMPLOYMENT CONTRACT

This Agreement of Employment made between the undersigned persons, hereafter referred to as the "clients", and Byron Hanna and Harold Morton, co-partners, practicing law, under the name of Hanna and Morton, hereafter referred to as the "attorneys", Witnesseth;

Whereas, the clients desire to have the attorneys file the necessary suit (or suits) on behalf of the clients as plaintiffs for an accounting and damages, or other relief, arising out of the sale in 1915 and

1917 of certain parts of Section 24, Township 26 South, Range 20 East, M. D. B. & M., Kern County, California, against the Anglo & London-Paris National Bank, Herbert Fleishhacker, California Star Oil Company, Security Oil Company, and others, as defendants; and

Whereas, the clients and the attorneys desire to enter into an agreement respecting the fees and costs and expenses of such litigation;

Now, Therefore, it is agreed as follows:

Fees and Costs

The clients will pay to the attorneys the sum of Thirty Thousand Dollars (\$30,000.00) and a contingent fee based on the amount of all sums or things of value recovered as a result of such suit (or suits) of 15% of the first million [18] dollars recovered and 10% of all sums in excess of one million dollars, payable only when and as received by the clients and in the same money or things of value as are received by the clients. Of said \$30,000.00 the attorneys have heretofore been paid \$2,500.00, and the balance of \$27,500.00 will be paid forthwith upon the execution of this agreement.

The said attorneys agree that in consideration thereof they will bear and pay all expenses and costs of such suit or suits, including all appeals, and hold the clients harmless by reason thereof.

The said attorneys are authorized to do all things appearing to them to be necessary and proper in protecting the rights of the clients with respect to said suit (or suits) and they agree to diligently prosecute the same to their best ability.

Settlement

Should a settlement of such controversies with the defendants be proposed or considered at any time, the question of whether such settlement should be made will be decided by a majority vote of the several clients and the attorneys, in which vote the attorneys shall have a 15% vote and the clients an 85% vote, the 85% being divided among the [19] clients in accordance with their respective interests in the controversies.

Provided further, that if any settlement be agreed upon, the attorneys shall receive a contingent fee of one-half of the amounts heretofore specified, that is to say, they will receive 7½% of the first million dollars recovered, and 5% thereafter.

1911 Sale

The attorneys agree that in the prosecution and investigation of the 1915 and 1917 sales referred to, they will endeavor to gather information as to the facts of a sale in 1911 made by the said Anglo & London-Paris National Bank of property in which the clients were interested. All such information will be placed at the disposal of the clients.

If it appears to the attorneys that a cause of action exists arising out of such 1911 sale, they will forthwith so advise the clients and will prepare the necessary complaint and prosecute a suit for relief by reason of such 1911 sale without further cash payment, upon an entirely contingent fee basis equal to that hereinbefore provided as to such 1915 and 1917 sales.

One or more duplicates of this agreement may be [20] signed. This contract effective only after signature of attorneys at Los Angeles, California.

[21]

State of California

County of Los Angeles—ss.

Byron C. Hanna, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true except those stated to be upon information and belief, and that those he believes to be true.

BYRON C. HANNA

Subscribed and sworn to before me this 6th day of February, 1943.

[Seal] ELSIE H. MacDONELL

Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: Filed T. C. U. S. Feb. 10, 1943. [22]

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) and (2). Admits the allegations contained in paragraphs (1) and (2) of the petition.

(3). Admits the allegations contained in paragraph (3) regarding the deficiencies asserted for the years 1939 and 1940, and understands that no question is now raised in this case regarding the year 1939.

(4). Denies the allegations of error contained in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5). Denies the allegations of fact contained in subparagraphs A. to O., inclusive, of paragraph (5) of the petition, except that the respondent admits the facts stated in the second unnumbered [23] paragraph of subparagraph J. of paragraph (5) of the petition.

(6). Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore it is prayed that the determination of the Commissioner be approved.

(Signed) J. P. WENCHEL ACB

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel.

EARL C. CROUTER,

Speical Attorney,

Bureau of Internal Revenue.

ECC/fmt 4/3/43

[Endorsed]: Filed T. C. U. S. April 8, 1943. [24]

The Tax Court of the United States

Docket Nos. 739, 7400.

BYRON C. HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

A. Calder Mackay, Esq., and Adam Y. Bennion,
Esq., for the petitioners.

Earl C. Crouter, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION.

Hill, Judge: The Commissioner determined deficiencies of \$4,134.55 and \$3,476.26 in the income taxes of Byron C. Hanna and Daisy May Hanna, respectively, for the calendar year 1940. The sole question presented for our determination is whether respondent erred in denying application of section 107 of the Internal Revenue Code.

FINDINGS OF FACT

Byron C. Hanna and Daisy May Hanna, the petitioners, were husband and wife, residents of Cali-

fornia during 1940 and all other times herein mentioned. They filed individual income tax returns for that year on the community property basis with the collector of internal revenue for the [25] sixth collection district of California. During the taxable year and all other years herein mentioned Byron C. Hanna and Harold C. Morton were law partners known by the firm name of Hanna and Morton.

In July 1932 Etienne Lang, as agent for the members of a Lazard family of France, consulted Hanna and Morton with reference to claims against the Anglo-California National Bank of San Francisco, Herbert Fleishhacker, its president, and others. These claims arose out of certain acts of the Bank and Fleishhacker as agents of the Lazards in the sale some 17 years earlier of lands in California belonging to the Lazards. At that time Lang employed Hanna and Morton to render an opinion on the validity of the claims and to draft a specimen form of complaint. Lang paid Hanna and Morton \$2,500 for these services. There was no obligation on the part of Lang or the Lazards to employ Hanna and Morton for further services and no obligation on the part of Hanna and Morton to accept such employment.

In October 1932, after consulting with other lawyers, Lang employed Hanna and Morton to proceed with the case. Lang and Morton agreed that \$27,500 would be advanced to Hanna and Morton to cover costs and expenses, with the understanding that if any balance should remain at the conclusion of the employment, it would belong to Hanna and Morton.

It was understood that Hanna and Morton received these funds for such purposes only and the accounts of Hanna and Morton dealing with the funds were frequently inspected by Lang. The books of Hanna and Morton designated the fund as a "Trust Account." The \$27,500 was paid over on October 15, 1932, and the receipt given for it read "Lazard Matter, On Account, Trust Acct." It was further agreed that Hanna and Morton would be responsible for any [26] expenses beyond the \$27,500. In addition to any balance remaining of the \$27,500 their fee was to be 15 per cent of the recovery.

For some time \$20,000 of the fund was left on deposit in the firm's name in two savings banks. Lang knew and approved of this. The funds were never kept in a separately designated trust account. Lang knew of this and acquiesced in it.

A total of \$1,168.86 in interest accrued on the savings accounts. During the years 1934 to 1936 Hanna and Morton withdrew this interest for their own unrestricted use having been told by Lang that they could keep it. They were to return it if it ever became necessary to complete the payment of expenses, their obligation in any event being to meet all expenses over the \$27,500. The interest so received was currently reported as income by Hanna and Morton. This interest was a fee for services when it was so withdrawn by Hanna and Morton.

Lang agreed to the withdrawal of \$2,000 by Hanna and Morton as fees at the time the \$27,500 was first paid over in October 1932. Later in the same month an additional \$1,500 was withdrawn as

a fee with Lang's approval. A further fee with-
drawal of \$1,000 was made on May 1, 1933, with
Lang's permission and again on October 31, 1936,
Lang gave Morton his consent for the firm to with-
draw \$1,000. Each of these fees was paid subject
to the understanding that Hanna and Morton were
to make up any deficits for expenses beyond the
original amount paid to them for that purpose.
They included these fees as compensation in their
income tax returns in the years received. [27]

Hanna and Morton successfully tried the case for
the Lazards and on January 19, 1940, the Bank
paid \$746,354.95 in satisfaction of the judgment.
From this amount Hanna and Morton received on
that day \$114,018.19, consisting of the contingent
fee in the amount of \$111,588.84 and \$2,429.35 re-
imbursement of costs expended from the \$27,500
fund. At that time, exclusive of the reimbursement
for costs, there was a balance of \$7,769.55 of the
original \$27,500 which Hanna and Morton also re-
ceived pursuant to the arrangement previously
made. Thus, Hanna and Morton received fees of
\$1,168.86 and \$5,500 prior to completion of the
services in 1940 and \$121,787.74 on completion of
those services in 1940.

Viewing the original payment of \$2,500 as being
for a separate and distinct employment, addition
of these figures indicates that a total fee of \$128,-
456.60 was received by Hanna and Morton on this
case. Of this amount, \$121,787.74, or 94.8 per cent,
was paid on the completion of the services.

OPINION.

The sole issue is whether petitioners are entitled to have their share of a fee for legal services received in 1940 taxed under the provisions of section 107 of the Internal Revenue Code.¹ In order for the section to apply "not less than 95 per centum" of the compensation must be paid only on completion of the services. The Regulations provide that "Section 107 is applicable only where at least 95 per cent of the total compensation for such services is paid on or after their completion."

Treasury Regulations 103, Sec. 19,107-1.

On the completion of their services for the Lazards in 1940 Hanna and Morton received a final fee of \$121,787.74. During the years 1932 through 1936 they received a total of \$6,668.86 in fees on the same case. The fact that Hanna and Morton

1. Section 107, Internal Revenue Code, added by section 220 of the Revenue Act of 1939:

Sec. 107. Compensation for Services Rendered for a Period of Five Years or More.

In the case of compensation (a) received, for personal services rendered by an individual in his individual capacity, or as a member of a partnership, and covering a period of five calendar years or more from the beginning to the completion of such services, (b) paid (or not less than 95 per centum of which is paid) only on completion of such services, [28] and (c) required to be included in gross income of such individual for any taxable year beginning after December 31, 1938, the tax attributable to such compensation shall not be greater than the aggregate of the taxes attributable to such compensation had it been received in equal portions in each of the years included in such period. [29]

were under the contingent liability of meeting any expenses after the exhaustion of the \$27,500 fund paid to them by Lang for expenses did not prevent the payments to them of \$5,500 from the principal of the fund and \$1,168.86 interest on the fund from being fees and income in the years in which received. Cf. *North American Oil Consolidated v. Burnet*, 286 U. S. 417; *Blum v. Helvering*, 74 Fed. (2d) 482, cert. denied 295 U. S. 732; *Highland Milk Condensing Co. v. Phillip*, 34 Fed. (2d) 777, cert. denied 280 U. S. 608.

Since the \$121,787.74 received on completion of the services is 94.8 per cent of \$128,456.60, the entire compensation, the petitioners fail to meet the explicit requirements of section 107.

Enter: Jan. 15, 1945.

Decisions will be entered for the respondent. [30]

The Tax Court of the United States
Washington

Docket No. 739

BYRON C. HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion entered January 15, 1945, it is

Ordered and Decided: That there is a deficiency in income tax for the calendar year 1940 in the amount of \$4,134.55.

(Signed) SAM B. HILL,
Judge.

Entered Jan. 15, 1945. [31]

United States Circuit Court of Appeals
for the Ninth Circuit

No. 739.

BYRON C. HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW OF DECISION OF
THE TAX COURT OF THE UNITED
STATES.

To the Honorable Judges of the United States
Circuit Court of Appeals for the Ninth Circuit:

Comes now Byron C. Hanna, petitioner herein,
and respectfully shows:

NATURE OF THE CONTROVERSY

The Respondent determined a deficiency in the income tax against the Petitioner for the calendar year 1940 in the amount of \$4,134.55.

This deficiency arose from the denial of the application of Section 107 of the Internal Revenue Code to a fee received in the calendar year 1940 by the firm of Hanna and Morton, lawyers, of which firm the petitioner is a partner.

In a companion proceeding the Commissioner also [32] determined a deficiency of \$3,476.26 in the income tax of Daisy May Hanna, wife of petitioner, for the calendar year 1940, arising from the denial to said Daisy May Hanna of the application of Section 107 of the Internal Revenue Code in her return of her community interest in the said fee received during the calendar year 1940.

Petitioner and his said wife, Daisy May Hanna, each filed an appeal to the Tax Court of the United States, which appeals were upon the trial thereof consolidated for trial and opinion.

Thereafter, on January 15, 1945. The Tax Court of the United States rendered its decision in favor of the respondent, and a copy of said decision is attached to this petition. Said decision describes in detail the controversy involved, which, briefly, is as follows:

In October, 1932 Harold C. Morton and petitioner were each attorneys at law, admitted to practice as such in all courts of the State of California and in the United States District Courts in the State of California and in the Circuit Court of Appeals for the Ninth Circuit, and were engaged in the practice of law in the City of Los Angeles, under the firm name and style of Hanna and Morton.

In October, 1932 Hanna and Morton were em-

ployed to prosecute a certain action against the Anglo-California National Bank of San Francisco and Herbert Fleishhacker. [33] At that time they received \$27,500 in trust to be utilized for expenses in said litigation. The litigation was instituted and continued until 1940, during which year it was successfully concluded.

During the period of the pendency of the litigation Hanna and Morton were also employed by the same clients to prosecute other actions and legal proceedings separate and distinct from the specific employment above referred to.

During the period of the pendency of the specific litigation above referred to, Hanna and Morton were permitted by their clients to withdraw from the trust funds various amounts thereof, aggregating \$5,500. Said withdrawals were made with the understanding and upon the agreement that Hanna and Morton would reimburse the trust fund for the amount thereof if required for the payment of costs.

During said period interest accrued in the total amount of \$1,168.86 on the deposit of said trust funds in savings accounts, and Hanna and Morton were permitted by their clients to withdraw this amount with the understanding and upon the promise that it would be returned if necessary for the payment of expenses.

Upon the conclusion of the litigation Hanna and Morton received a fee of \$121,787.74 for their services under said specific employment, plus release of the obligation to return the interest withdrawn

as aforesaid and to reimburse the trust fund for the amounts withdrawn as aforesaid, making [34] a total of \$128,456.60.

The Tax Court of the United States decided that the total fee received by Hanna and Morton in said employment was the latter amount, and that of this amount only \$121,787.74, or 94.8 per cent, was paid on the completion of the services. There was thus decided to be a deficit of one-fifth of one per cent ($\frac{1}{5}$ of 1%) of the amount necessary to be received upon the completion of the services to entitle petitioner to the benefit of the provisions of Section 107 of the Internal Revenue Code.

Petitioner contends that The Tax Court erred in the following particulars:

(a) in finding as a fact or deciding as a matter of law that the withdrawals aforesaid from the trust funds, amounting to \$5,500, constituted payment of a part of the fee for the services rendered in the employment in question to Hanna and Morton when and as received by Hanna and Morton;

(b) in finding as a fact or deciding as a matter of law that the withdrawal of accrued interest on the trust fund, as aforesaid, amounting to \$1,168.86, constituted payment of a part of the fee for the services rendered in the employment in question to Hanna and Morton when and as received by Hanna and Morton; and

(c) in determining that less than 95% of the fee of Hanna and Morton for services under the employment above-mentioned was received in the calendar year 1940. [35]

II.

THE COURT IN WHICH REVIEW IS
SOUGHT

The United States Circuit Court of Appeals for the Ninth Circuit is the Court in which review of said decision of The Tax Court of the United States is sought pursuant to the provisions of Section 1141 of the Internal Revenue Code.

III.

VENUE.

The decision of the United States Tax Court herein was rendered on January 15, 1945. For more than fifty years last past immediately preceding, petitioner has resided in the County of Los Angeles, State of California. He filed his Federal Income Tax returns for the calendar year 1940, and also for all other calendar years since 1916 or thereabouts, with the United States Collector of Internal Revenue for the Sixth Collection District of California, whose office is located at Los Angeles, California and within the Ninth Judicial Circuit of the United States.

The parties hereto have not stipulated that said decision may be reviewed by any Court of Appeals other than the one herein designated. [36]

Wherefore, the Petitioner prays that the decision of The Tax Court of the United States herein be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of

the record be prepared in accordance with the law and rules of said Court and transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

Dated: April 7, 1945.

A. CALDER MACKAY

ADAM Y. BENNION

Attorneys for Petitioner. [37]

The Tax Court of the United States

Docket Nos. 739, 740.

BYRON C. HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

A. Calder Mackay, Esq., and Adam Y. Bennion, Esq., for the petitioners. Earl C. Crouter, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND
OPINION

Hill, Judge: The Commissioner determined deficiencies of \$4,134.55 and \$3,476.26 in the income taxes of Byron C. Hanna and Daisy May Hanna, respectively, for the calendar year 1940. The sole question presented for our determination is whether respondent erred in denying application of section 107 of the Internal Revenue Code.

FINDINGS OF FACT.

Byron C. Hanna and Daisy May Hanna, the petitioners, were husband and wife, residents of California during 1940 and all other times herein mentioned. They filed individual income tax returns for that year on the community property basis with the collector of internal revenue for the sixth collection district of California. During the taxable year and all other years herein mentioned Byron C. Hanna and Harold C. Morton [38] were law partners known by the firm name of Hanna and Morton.

In July 1932 Etienne Lang, as agent for the members of a Lazard family of France, consulted Hanna and Morton with reference to claims against the Anglo-California National Bank of San Francisco, Herbert Fleishhacker, its president, and others. These claims arose out of certain acts of the Bank and Fleishhacker as agents of the Lazards in the sale of some 17 years earlier of lands in California to the Lazards. At that time Lang employed Hanna and Morton to render an opinion on the validity of the claims and to draft a specimen form of com-

plaint. Lang paid Hanna and Morton \$2,500 for these services. There was no obligation on the part of Lang or the Lazards to employ Hanna and Morton for further services and no obligation on the part of Hanna and Morton to accept such employment.

In October 1932, after consulting with other lawyers, Lang employed Hanna and Morton to proceed with the case. Lang and Morton agreed that \$27,500 would be advanced to Hanna and Morton to cover costs and expenses, with the understanding that if any balance should remain at the conclusion of the employment, it would belong to Hanna and Morton. It was understood that Hanna and Morton received these funds for such purposes only and the accounts of Hanna and Morton dealing with the funds were frequently inspected by Lang. The books of Hanna and Morton designated the fund as a "Trust Account." The \$27,500 was paid over on October 15, 1932, and the receipt given [39] for it read "Lazard Matter, On Account, Trust Acct." It was further agreed that Hanna and Morton would be responsible for any expenses beyond the \$27,500. In addition to any balance remaining of the \$27,500 their fee was to be 15 per cent of the recovery.

For some time \$20,000 of the fund was left on deposit in the firm's name in two savings banks. Lang knew and approved of this. The funds were never kept in a separately designated trust account. Lang knew of this and acquiesced in it.

A total of \$1,168.86 in interest accrued on the savings accounts. During the years 1934 to 1936

Hanna and Morton withdrew this interest for their own unrestricted use having been told by Lang that they could keep it. They were to return it if it ever became necessary to complete the payment of expenses, their obligation in any event being to meet all expenses over the \$27,500. The interest so received was currently reported as income by Hanna and Morton. This interest was a fee for services when it was so withdrawn by Hanna and Morton.

Lang agreed to the withdrawal of \$2,000 by Hanna and Morton as fees at the time the \$27,500 was first paid over in October 1932. Later in the same month an additional \$1,500 was withdrawn as a fee with Lang's approval. A further fee withdrawal of \$1,000 was made on May 1, 1933, with Lang's permission and again on October 31, 1936, Lang gave Morton his consent for the firm to withdraw \$1,000. Each of these fees was paid subject to the understanding that Hanna and Morton were to make up any [40] deficits for expenses beyond the original amount paid to them for that purpose. They included these fees as compensation in their income tax returns in the years received.

Hanna and Morton successfully tried the case for the Lazards and on January 19, 1940 the Bank paid \$746,354.95 in satisfaction of the judgment. From this amount Hanna and Morton received on that day \$114,018.19, consisting of the contingent fee in the amount of \$111,588.84 and \$2,429.35 reimbursement of costs expended from the \$27,500 fund. At that time, exclusive of the reimbursement for costs, there was a balance of \$7,769.55 of the original

\$27,500 which Hanna and Morton also received pursuant to the arrangement previously made. Thus, Hanna and Morton received fees of \$1,168.86 and \$5,500 prior to completion of the services in 1940 and \$121,787.74 on completion of those services in 1940.

Viewing the original payment of \$2,500 as being for a separate and distinct employment, addition of these figures indicates that a total fee of \$128,456.60 was received by Hanna and Morton on this case. Of this amount, \$121,787.74, or 94.8 percent, was paid on the completion of the services.

OPINION

The sole issue is whether petitioners are entitled to have their share of a fee for legal services received in 1940 taxed under the provisions of section 107 of the Internal Revenue [41] Code.¹ In

¹Section 107, Internal Revenue Code, added by section 220 of the Revenue Act of 1939:

Sec. 107. Compensation for Services Rendered for a Period of Five Years or More.

In the case of compensation (a) received, for personal services rendered by an individual in his individual capacity, or as a member of a partnership, [42] and covering a period of five calendar years or more from the beginning to the completion of such services, (b) paid (or not less than 95 per centum of which is paid) only on completion of such services, and (c) required to be included in gross income of such individual for any taxable year beginning after December 31, 1938, the tax attributable to such compensation shall not be greater than the aggregate of the taxes attributable to such compensation had it been received in equal portions in each of the years included in such period.

order for the section to apply "not less than 95 per centum" of the compensation must be paid only on completion of the services. The Regulations provide that "Section 107 is applicable only where at least 95 per cent of the total compensation for such services is paid on or after their completion." Treasury Regulations 103, Sec. 19,107-1.

On the completion of their services for the Lazards in 1940 Hanna and Morton received a final fee of \$121,787.74. During the years 1932 through 1936 they received a total of \$6,668.86 in fees on the same case. The fact that Hanna and Morton were under the contingent liability of meeting any expenses after the exhaustion of the \$27,500 fund paid to them by Lang for expenses did not prevent the payments to them of \$5,500 from the principal of the fund and \$1,168.86 interest on the fund from being fees and income in the years in which received. Cf. *North American Oil Consolidated v. Burnet*, 286 U. S. 417; *Blum v. Helvering*, 74 Fed. (2d) 482, cert. denied 295 U. S. 732; *Highland Milk Condensing Co. v. Phillip*, 34 Fed. (2d) 777, cert. denied 280 U. S. 608.

Since the \$121,787.74 received on completion of the services is 94.8 percent of \$128,456.60, the entire compensation, the petitioners fail to meet the explicit requirements of section 107.

Decisions will be entered for the respondent.

(Entered Jan. 15, 1945)

[Endorsed]: Filed T.C.U.S. April 12, 1945

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR
REVIEW

To John F. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C., Attorney for the Respondent:

Please Take Notice that on the 12th day of April, 1945, the undersigned filed with the Clerk of the Tax Court of the United States the petition of Byron C. Hanna, a copy of which is annexed hereto, for the review by the United States Circuit Court of Appeals for the Ninth Circuit of the final order and decision of the Court heretofore rendered in the above entitled case.

A. CALDER MACKAY

ADAM Y. BENNION

Attorneys for the Petitioner

ADMISSION OF SERVICE

Service of a copy of the above notice and a copy of the petition for review is hereby accepted this 13th day of April, 1945.

J. P. WENCHEL

Chief Counsel, Bureau of Internal Revenue

Attorney for the Respondent.

[Endorsement]: Filed T.C.U.S. April 13, 1945.

[44]

[Title of Tax Court and Cause.]

STIPULATION

Whereas the above-entitled cause involves the same questions as are involved in a companion case before the above-entitled Court, entitled “Daisy May Hanna, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 740”, and

Whereas said cause and this cause were consolidated before the above-entitled Court for purposes of trial and decision, and

Whereas the evidence in both of these causes is identical, and

Whereas a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the above-entitled Court has been filed in said cause No. 740, as well as in this cause, and

Whereas a statement of the evidence has been prepared, served and filed in said cause No. 740 and the evidence in said cause is identical with the evidence in this cause, [45]

Now, Therefore, it is hereby stipulated and agreed that the statement of the evidence in said cause No. 740 is hereby adopted as the statement of the evidence in this cause and with the same force and effect and to all intents and purposes as though a duplicate of said statement of the evidence had been prepared, served and filed in this cause; and that it shall be deemed that the statement of the evidence

prepared, served and filed in said cause No. 740 is a statement of the evidence prepared, served and filed in this cause.

Dated: May 4, 1945.

A. CALDER MACKAY and
ADAM Y. BENNION

A. Calder Mackay

By Adam Y. Bennion

Attorneys for Petitioner

(Signed) J. P. WENCHEL, CAR.

[Endorsed]: Filed T.C.U.S. May 19, 1945. [54]

[Title of Circuit Court of Appeals and Cause.]

PETITIONER'S STATEMENT OF POINTS TO
BE RELIED ON AND DESIGNATION
OF PARTS OF THE RECORD TO BE
PRINTED

Comes now Byron C. Hanna, the petitioner for review in the above-entitled cause, and states that the points on which he intends to rely in this case are as follows:

1. The Tax Court of the United States erred in finding as a fact or deciding as a matter of law that the withdrawals from the \$27,500 trust fund mentioned in the Findings, amounting to \$5,500, constituted payment of a part of the fee for the services rendered in the employment mentioned in the

Finding, to Hanna and Morton when and as received by Hanna and Morton;

2. The Tax Court of the United States erred in finding as a fact or deciding as a matter of law that the withdrawal of accrued interest on the said trust fund, amounting to \$1,168.86, constituted payment of a part of the fee for the services rendered in the said employment to Hanna and Morton when and as received by Hanna and Morton; and

3. The Tax Court of the United States erred [47] in determining that less than 95% of the fee of Hanna and Morton for services under the employment above mentioned was received in the calendar year 1940.

Petitioner hereby designates the entire record, as certified to the Clerk of the above-entitled Court, as necessary to be printed for the consideration of the points set forth above.

A. CALDER MACKAY and
ADAM Y. BENNION

By A. CALDER MARKAY
Attorneys for Petitioner

Service admitted 5/18/45.

(Signed) J. P. WENCHEL, CAR.

[Endorsed]: Filed T.C.U.S. May 19, 1945 [48]

[Title of Circuit Court of Appeals and Cause.]

PETITIONER'S DESIGNATION OF
CONTENTS OF RECORD ON REVIEW

Petitioner hereby designates for inclusion in the record on review in the above-entitled proceeding, the following:

The complete record of all the proceedings and evidence taken before The Tax Court of the United States and all matters required by Subdivision (g) of Rule 75 of the Federal Rules of Civil Procedure; excepting exhibits filed as evidence, but including the stipulation adopting as a statement of evidence in this cause the statement of evidence prepared, served and filed in the cause of Daisy May Hanna, Petitioner vs. Commissioner of Internal Revenue, Respondent, No. 740.

Dated: May 4, 1945.

A. CALDER MACKAY and
ADAM Y. BENNION
A. Calder Mackay

By Adam Y. Bennion

Attorneys for Petitioner.

(Signed) J. P. WENCHEL, CAR.

[Endorsed]: Filed T. C. U. S. May 19, 1945. [49]

[Title of Tax Court.]

CERTIFICATE

I, B. D. Gamble, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 49, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 4th day of June, 1945.

[Seal]

B. D. GAMBLE

Clerk, The Tax Court of the
United States.

[Endorsed]: No. 11070. United States Circuit Court of Appeals for the Ninth Circuit. Byron C. Hanna, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed June 11, 1945.

PAUL P. O'BRIEN

Clerk of the United States
Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit
No. 739.

BYRON C. HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ORDER

For cause appearing of record, it is hereby

Ordered: That the time for transmission and delivery of the record on petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Ninth Circuit be and it is hereby extended to June 22, 1945.

FRANCIS A. GARRECHT

Judge

Dated May 18, 1945, San Francisco, California

[Endorsed]: Filed May 18, 1945. Paul P. O'Brien, Clerk.

A True Copy. Attest: May 18, 1945.

/s/ PAUL P. O'BRIEN,

Clerk.

Now: June 5, 1945, the foregoing order is certified from the record as a true copy.

[Seal]

B. D. GAMBLE

B. D. Gamble

Clerk.

[Endorsed]: T.C.U.S. Filed May 23, 1945.